Swala Energy (SWE)

Exploring the FrontEARS

Recommendation: Speculative BUY

Key Points

- ***Highly prospective frontier acreage in the rapidly emerging East African Rift System ("EARS")***
- ***The last decade has seen significant oil discoveries in the limited areas drilled to date in the region, with a high drilling success rate***
- ***Work to date by Swala has identified key prospects with strong similarities to the recent EARS discoveries***
- ***Three wells on three licences planned in early 2016***
- ***Drilling is largely funded, with key partners including Tullow Oil***
- ***Prudent funding strategy in place in response to current tight capital markets***

Swala, which has been operating in the EARS since 2012, has defined a number of key prospects, with three wells planned for early 2016. The prospects are located over undrilled segments of the EARS; however work carried out to date indicates strong similarities to recent discoveries, including those in the Albertine Rift of Uganda and South Lokichar Basin of Kenya.

The wells are planned over three licences – two in Tanzania where Swala is operator and one in Kenya where Tullow Oil is operator. Dependent upon the successful closure of a farm-out deal on the Tanzanian licences, Swala will be fully carried on the cost of the Tanzanian drilling, with the deal also providing working capital for the Company.

The falling oil price and tough capital markets have made it hard for junior explorers; however Swala has adopted a commercially prudent farm-out strategy, whilst still retaining interests that provide good leverage to any drilling success.

We rate Swala as a SPECULATIVE BUY, with the key price mover being success in the upcoming drilling programs, to which value is highly leveraged. Investor interest in Swala will inevitably rise as the drilling schedule firms up.

Company Overview

Swala is an ASX-listed junior oil exploration company concentrating activities on the highly prospective East African Rift System in Tanzania and Kenya. The Company has held its key licences since 2012, and has progressed them to the stage where drill prospects have been defined, with drilling now due in 2016.

Swala is continually looking at new opportunities to expand its land bank in the region, and recently accepted an offer of a block in Zambia, located over the older Karoo system, and is participating in the current Ugandan licencing round.

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Breakaway Research

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Company Information

ASX Code	**SWE**
Share Price (24 June 15)	A$0.068
Ord Shares	159.4m
Performance Shares	15.0m
Options	8.7m
Market Cap (FD)	**A$12.45m**
Cash est.	A$1.00m
Convertible Notes	A$0.64m[1]
Debt	A$1.3m[2]
Enterprise Value	**A$13.23m**

1 – 476,191 US$1.05 convertible notes
2 – US$1 million interim fnding facility with Hayaat

Directors & Management

Non-Exec Chairman	Ken Russell
CEO and MD	David Mestres Ridge
Non-Exec Director	Peter D. Grant
Non-Exec Director	Ernest Massawe
Non-Exec Director	Mohammed Ishtiaq
Non-Exec Director	Frank Moxon
New Ventures Manager	Neil C. Taylor

Company Details

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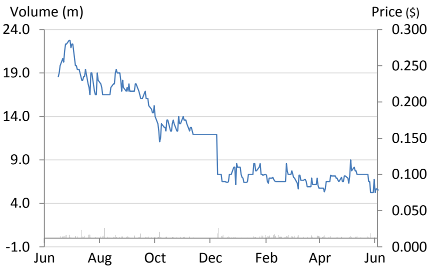
Top Five Shareholders

OCRA Trustees	12.38%
Mr. Neil Taylor	10.56%
Hayaat International	9.12%
Pershing Australia Nominees	3.23%
Energy Tanzania Limited	3.14%
Top 20	58.60%

1 Year Price Chart



Source: IRESS

Investment Thesis

Highly Prospective East African Rift System Projects

Highly prospective EAR acreage

Swala Energy (ASX: SWE, "Swala" or "the Company") has both operating and non-operating interests in frontier licences in Tanzania and Kenya within the highly prospective EARS. In addition to its JV partner, Otto Energy (ASX: OEL), Swala is the only other ASX-listed explorer operating onshore in the region.

The EARS is Hot – Discoveries at the Albertine Rift and Lokichar Basin

Significant oil discoveries over the last decade in the EARS

The EARS comprises approximately 3,500km of continental rifting, however is largely under or un-explored, with only limited drilling. Drilling has been concentrated on two areas, the Albertine Rift of Uganda and the South Lokichar Basin of Kenya, where current operators, Tullow Oil plc ("Tullow", LSE: TLW) and Africa Oil Corp. (Africa Oil, TSX: AOI) have made significant discoveries over the last decade, delineating 2C resources of at least 2.3 billion barrels over the two rifts, including commercialised reserves in the Albertine Basin of around 600 million barrels.

Africa Oil has reported a 72% success rate for wells in their licences – an exceptional hit rate for oil and gas exploration in a frontier province, with Tullow also reporting high success rates, particularly in recent field appraisal drilling.

Little Drilling Elsewhere

Large areas remain underexplored

Despite these successes, there has been limited drilling in other areas of the EARS. Africa Oil is now carrying out an extensive programme over its Eastern Branch tenements, and the work to date on Swala's tenements has delineated a number of leads and prospects, with drilling now planned.

Kilombero - a Lokichar Lookalike?

Swala's Kilombero Basin has similarities to the South Lokichar Basin

Work by Swala Oil and Gas (Tanzania) PLC ("SOGTP", a 58.2% held subsidiary of Swala), has shown similarities between the Kilombero Basin, where the Company has an interest in the Kilosa-Kilombero licence, and the South Lokichar Basin. This work has identified a number of leads and prospects along the western basin margin, a similar geometry to that seen at Lokichar, with the hydrocarbon potential also supported by the presence of distressed vegetation (possibly indicating hydrocarbon contamination) along the boundary fault.

Tanzanian Drilling Fully Funded

Planned Tanzanian drilling is fully funded

SOGTP is now preparing to drill at Kilombero, with this fully funded (subject to government approval of the deal) by virtue of a recent US$5.7m 25% equity farm-out to Tata Petrodyne Limited ("TPL") of its Tanzanian assets. TPL is a fully owned subsidiary of the Indian listed multinational Tata Sons Limited. This farm-out also includes Pangani, the second Tanzanian Licence, which again has an initial well planned for early 2016.

With Tullow in Kenya

Kenyan licence is operated by Tullow, a successful player in the EARS

Swala's other key asset is Block 12B in Kenya, which it holds 50:50 with Tullow, which is the operator. Seismic work to date has defined 10 leads and prospects, and, like the Tanzanian assets, initial drilling is planned for 2016.

Regional Expansion Strategy

Swala is looking regionally, and recently was awarded Block 44 in Zambia. This is located over the older Karoo System, a widespread geological event in southern and east Africa. The Company is also participating in the current Ugandan licencing round, and is looking at other regional opportunities.

Funding Strategy in Place

Prudent funding strategy in place in response to tight markets

Dependent on completion of the TPL deal, Swala is now fully funded to progress most activities, being fully carried on the initial Tanzanian wells, and with the TPL farm-out to provide enough cash to meet the group's current obligations on other work commitments.

The Company is also looking at farm-out opportunities ahead of planned drilling on Block 12B in Kenya, and has undertaken a number of initiatives to cut overheads. Dependent upon circumstances, a listing on the London AIM market is a future possibility, which will expose the Company to the large oil and gas investment community in the UK.

Actively Engaging the Locals

One of the Company's key objectives is to generate a meaningful presence in the countries it operates in, and to engage local investors. As part of this SOGTP was listed on the Dar es Salaam Stock Exchange in 2014, given locals direct investment access to the oil and gas exploration game.

Experienced Board and Management…

The Board and Management have extensive experience in the oil and gas industry, as well as African experience and including African nationals.

Board and Management with significant experience and skin in the game

…with Skin in the Game

In addition they have significant shareholdings in Swala, which, in our view, is very positive and provides significant incentive for success. The register also includes very supportive cornerstone investors, including Hayaat International, which has provided interim funding to Swala.

Risks

As in any resources stock there are a number of risks – ones currently pertinent to Swala are discussed below.

- **Exploration** – This is the key risk for Swala, being a junior oil and gas exploration company. By its nature exploration is risky, especially in frontier areas; however the results of drilling and success rates in other areas of the EARS should give some confidence in the upcoming drilling. It does need to be noted however, that despite the similarities between the various basins/rifts in the EARS they are discrete entities, with their own inherent exploration characteristics.

- **Funding** – The Company would appear to be adequately funded by virtue of the TPL deal; however this is contingent on the deal closing and government approvals being obtained. A successful farm-out of part of the Kenyan interests will also provide additional funds.

- **Sovereign Risk and Permitting** – The countries that Swala is operating in have relatively low sovereign risk compared to a number of African jurisdictions, and, looking at the oil and gas exploration history have a well-developed legal framework for the industry. The countries have also had relatively stable governments over recent times, partially mitigating political risk.

- **Infrastructure** – Given the relatively recent nature of discoveries, there is no infrastructure, including refineries or pipelines, in place in the region. However, plans are afoot for a pipeline to the Kenyan coast that would serve the recent Ugandan and Kenyan discoveries. Significant discoveries in other areas would also potentially drive development of infrastructure.

Project and Activities Review

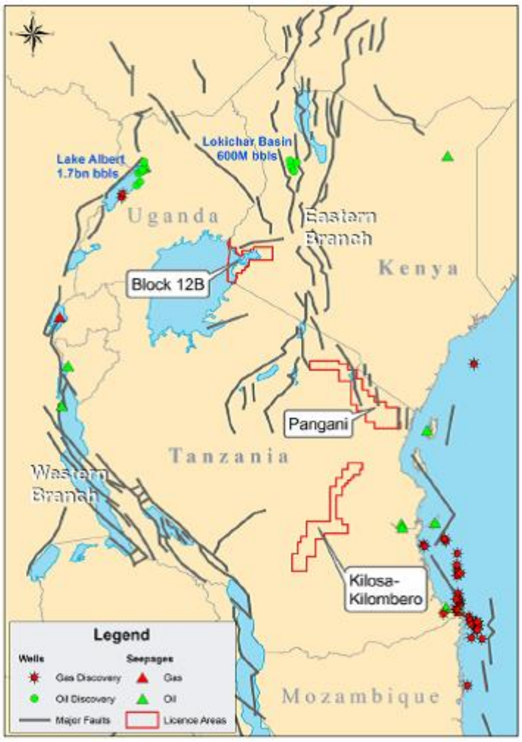
Introduction and Strategy

Swala is concentrating activities on the EARS, which, despite significant discoveries over the past decade, is under-explored

Swala is an ASX listed junior oil explorer, focussed on exploration in the East African Rift. This is largely underexplored frontier territory; however significant onshore discoveries in the Albertine Graben in Uganda and the South Lokichar Basin in Kenya by Tullow and Africa Oil over the past decade have made the region hot property, with current 2C resources in the order of 2.3 billion barrels, and with appraisal work underway in some areas. A background to the EARS and discoveries is included later in this report.

Swala has interests through subsidiaries in four projects as listed in the table and figure shown below. The portfolio assumes completion of the partial farm-out of the Tanzanian interests to TPL.

Swala Tanzanian and Kenyan project locations



Source: Swala Energy

Swala Energy Portfolio

Swala has interests in Tanzania, Kenya and Zambia

Country	Block	Holders	SWE Interest	Operator	Gross Area	Net Area
Tanzania	Kilosa-Kilombero	SOGTP – 25% TPL – 25% Otto – 50%	14.63%	Swala	17,675	2,585
Tanzania	Pangani	SOGTP – 25% TPL – 25% Otto – 50%	14.63%	Swala	17,156	2,509
Kenya	Block 12B	SEKL – 50% Tullow – 50%	50%	Tullow	8,000	4,000
Zambia	Block 44	SEZL – 100%	93%	Swala	6,000	5,580
Total					**48,831**	**14,674**

Source: Swala Energy

SOGTP – Swala Oil and Gas (Tanzania) PLC (SWE 58.5%), TPL – Tata Petrodyne Limited, Otto – Otto Energy Limited, SEKL – Swala Energy (Kenya) Limited (SWE 100%), SEZL – Swala Energy (Zambia) Limited (SWE 93%)

Given recent falling oil prices and tight capital markets, the Company has adopted a strategy of farming out interests in current tenements, which will provide working capital whilst not diluting corporate shareholdings. Shareholders will retain high leverage to the significant upside should a discovery be made. FirstEnergy Capital LLP ("FirstEnergy") was engaged to manage the process.

The Company has adopted a farm-out strategy to counter tight capital markets. This still provides shareholders considerable upside with any discovery

As announced to the market on June 1, 2015, TGL has agreed to acquire 25% of the Tanzanian tenements from SOGTP, and the Company is looking for farm-out partners for its Ugandan Block 12B project.

The Company is actively exploring other opportunities in the highly prospective EARS (and elsewhere) – this includes participating in the current Ugandan licencing round.

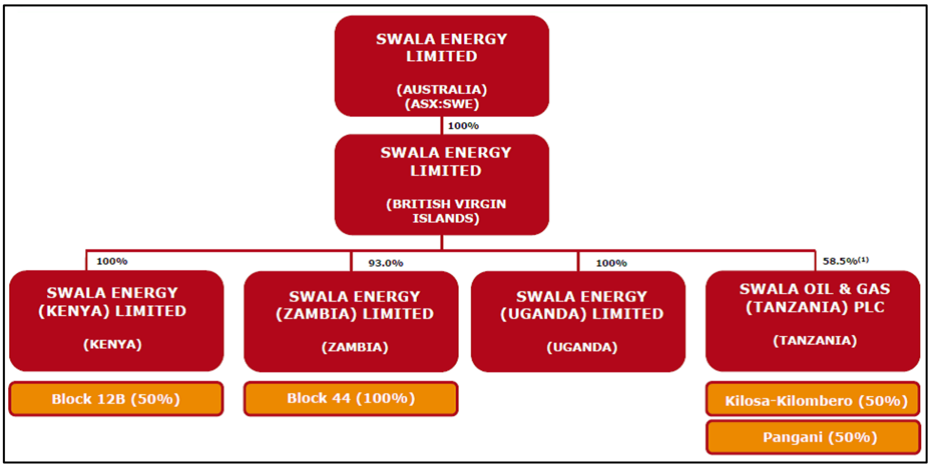
An AIM listing is also being explored, to provide access to the significant UK oil and gas capital markets.

Corporate

Structure

Swala's corporate structure is shown in the figure below. Note that the Tanzanian holdings are prior to the TPL farm-out – following approvals SOGTP's holdings will decrease to 25%.

Swala corporate structure



Source: Swala Energy

One key aspect of Swala's operations was the 2014 listing of SOGTP, originally a 100% held entity, on the Dar es Salaam Stock Exchange. This has reduced Swala's holding in SOGTP to 58.2%, and raised around US$2 million. This was a first for the region, and allows local investors to directly participate in the local oil and gas exploration sector.

Funding

As part of the proposed TPL farm-out, Swala has entered into an interim US$1 million loan arrangement with Hayaat International, a UAE based cornerstone investor in Swala. The loan is of two equal US$500,000 tranches, and will be repayable on receipt by Swala of the proceeds of the TPL farm-outs. There is no interest payable on the loan, however a fee of US$25,000 is payable on each US$500,000 tranche.

Current funding arrangements include a US$1 million interim debt facility with a major shareholder, and a convertible note facility

In December 2014 the Company entered into a US$2,250,000 convertible note facility with Magma, a US based investment firm. The facility included three US$750,000 tranches, of which the first has been drawn down, with the subsequent two draw-downs due at fixed intervals, and which are now not available. For each US$1.00 drawn down Swala issued Magma 12 month convertible notes with a face value of US$1.05 – there are now 476,191 notes outstanding. These can be converted into ordinary shares at any time during the term at a 15% discount to the lowest VWAP over the 5-day period prior to conversion. Magma has also agreed to certain restraints with regard to its ability to sell shares.

Tanzania – Kilosa-Kilombero and Pangani

Introduction and Tenure

The Tanzanian licences are held 25% by SOGTP (subject to closure of the TPL farm-out)

The Tanzanian licences, Kilosa-Kilombero and Pangani are held 25% by SOGTP (subject to closure of the TPL farm-in) and operated by SOGTP. These frontier licences are located over segments of the Eastern Branch of the EARS, and have had no previous drilling.

The Licences were granted on February 20, 2012, for an initial period of four years, with the licences currently in the fourth year. The following day SOGTP assigned 50% of the rights to both licences to Otto Energy (Tanzania), a wholly owned subsidiary of Otto Energy Limited (ASX: OEL, "Otto").

The projects are now in year 4 of the initial exploration period

Work commitments for both licences are presented in the table below. Commitments have been satisfied up to and including year 3 on both licences, with work now progressing on the year 4 commitments, and drilling expected early in 2016. A decision will be made to extend subject to the results of the drilling.

Tanzanian work commitments

Exploration Period	Contract Year	Work commitment	Minimum expenditure (US$)	
			Pangani Licence	Kilosa-Kilombero Licence
Initial Exploration Period	1	Acquire high-resolution airborne gravity and/or magnetic data; conduct ASTER satellite and photogeology work; undertake surface geochemical sampling; and carry out surface geological mapping.	370,000*	500,000*
	2	Acquire a minimum of 200 km (in the case of the Pangani Licence) and 300 km (in the case of the Kilosa-Kilombero Licence) of 2D seismic and to undertake additional geochemical sampling and surface geological mapping.	2,100,000	2,100,000
	3	Acquire a further 200 km (in the case of the Pangani Licence) and 500 km (in the case of the Kilosa-Kilombero Licence) of 2D seismic.	2,000,000	5,000,000
	4	Drill a well to a maximum of 3,000m or basement.	6,000,000	6,000,000
First Extension Period	5 to 8	Undertake further geological, geochemical and geophysical studies; acquire 60 km^2 of 3D seismic or 600 km of 2D seismic; and drill at least one well to a maximum depth of 3,000m or basement.	12,100,000	12,100,000
Second Extension Period	9 to 11	Undertake further geological, geochemical and geophysical studies; acquire 60 km^2 of 3D seismic or 600 km of 2D seismic; and drill at least one well to a maximum depth of 3,000m or basement.	12,100,000	12,100,000

Source: Swala Energy Prospectus

As announced on June 1, 2015 SOGTP has farmed out a further 25% to TPL, with approvals from the Tanzanian government pending, and expected by the end of August. Key terms of this farm-out include:

- TPL to acquire a 25% equity interest in the Kilosa-Kilombero and Pangani Licences from SOGTP
- On receipt of government approval, TPL will pay the sum of US$5.7 million to SOGTP as consideration for past costs incurred on the licences
- TPL will free carry SOGTP through the costs of the initial well at Kilosa-Kilombero (up to a maximum of US$2.5 million net) and the initial well at Pangani (up to a maximum of US$2.125 million net)
- TPL will pay SOGTP up to a further US$1.0 million towards the cost of a second well following a commercial discovery at Kilosa-Kilombero. Costs above this shall be borne pro-rata by the participants.

Work completed at Kilosa-Kilombero includes gravity, magnetics and seismic surveying

Kilosa-Kilombero

Kilosa-Kilombero is located over the Kilombero Rift, and work to date has defined three discrete basins – Kilombero, Kidatu and Kilosa. There has been no previous drilling in this rift.

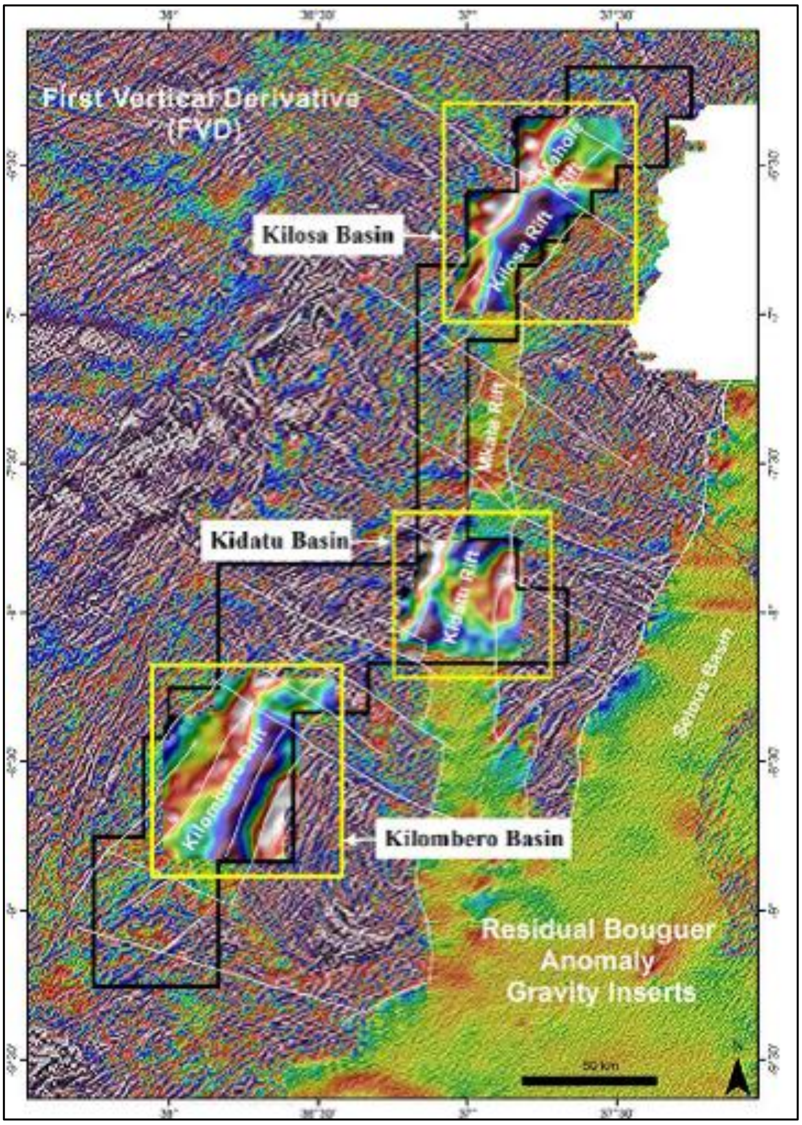
Work to date by SOGTP has included:

- Year 1 – Gravity and magnetics surveys
- Year 2 – Seismic acquisition – 100km over Kilombero, 130km over Kilosa, 143km over Kidatu
- Year 3 – Seismic acquisition – 430km over Kilombero

The results of the year 2 seismic surveys indicated the Kilombero Basin was the most prospective, with year 3 activities concentrated there.

Work has been carried out over three basins in the Kilombero Rift

Kilombero Rift structure



Source: Swala Energy

Seismic surveying indicates a half-graben structure, with up to 3,300m of basin fill

The recent work at the Kilombero Basin has indicated a half-graben structure, with depth to basement of up to 3,300m at the centre. Given the heat flows in the basin, this is sufficient, provided suitable source rocks are present, to provide a source kitchen for oil generation. The western boundary of the basin is a steeply dipping, east block down normal fault. Seismic work has identified "roll-over anticlines" (with no evidence of crustal breaching) near the basin margin – these are anticlines associated with basin growth faults and are considered prospective as hydrocarbon traps.

A key outcome has been the identification of the Kito Prospect on the western margin, which is estimated as containing a best estimate of 151MMstb gross prospective resources, as presented in the table below – this estimate is currently under review following the most recent seismic survey. This work has also identified a number of leads, also along the western margin of the rift, which may represent a "string of pearls", similar to discoveries in the South Lokichar Basin in Kenya.

Prospective resources of 151MMstb have been calculated for Kito

The Company is currently planning an initial well at Kito, with an estimated cost of US$10 million gross. It is planned that, dependent upon government approvals and completion of the TPL farm-in, this will be spudded in early 2016.

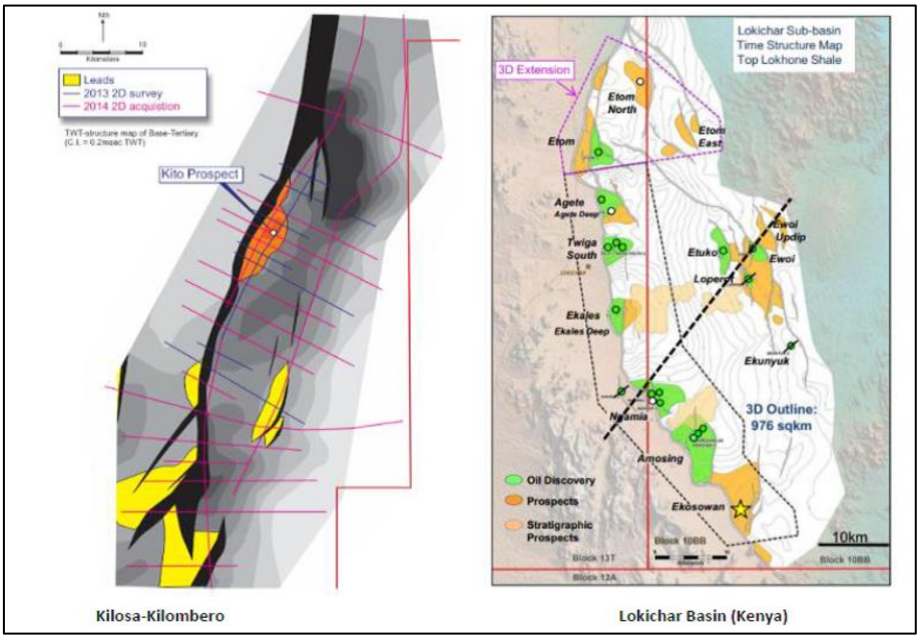
Prospective resources – Kito Prospect

Total Unrisked Prospective Oil Resources (MMstb)				
	Equity	Low Estimate	Best Estimate	High Estimate
Kito Prospect (Gross)	100%	48	151	424
SOGTP	25%	12	37.75	106
Tata	25%	12	37.75	106
Otto Energy Limited	50%	24	75.5	212
Swala Energy Limited	14.6%*	7.0	22.1	62.0

Source: Adapted from Swala Energy

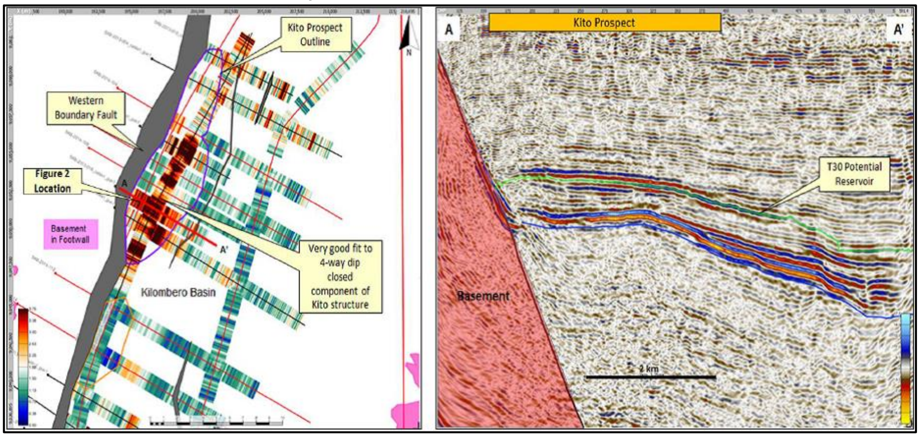
Kilombero shows similarities to Lokichar, in which a number of discoveries have been made

Kilombero-Lokichar comparison



Source: Swala Energy

Kito seismic section and map



Source: Swala Energy

Work at Pangani has included gravity, magnetics and seismic surveying

This has identified four leads in the Moshi Basin, with drill planning now underway

Pangani

Pangani is located over the Pangani Rift in northern Tanzania, one arm of the Northern Tanzanian Divergence triple junction. Work to date has identified two basins within the licence, Moshi and Mvungwe.

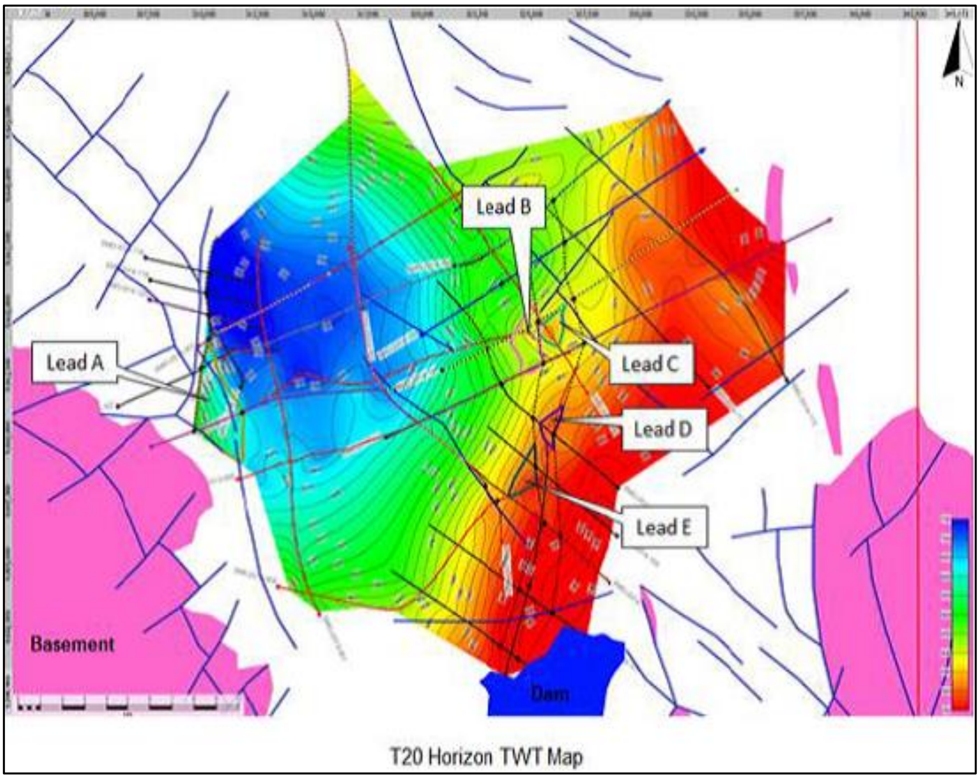
Activities by Swala have included:

- Year 1 – Gravity and magnetics surveys
- Year 2 – Seismic acquisition – 126km over Moshi, 74km over Mvungwe
- Year 3 – Seismic acquisition – 200km over Moshi

The work at Moshi has identified four leads, with interpretation work and drill planning continuing, and an initial well planned for early 2016. Interpretations indicate that Moshi is a fault bounded basin, some 25km wide, and with a depth to basement of between 2,000 and 3,000m. Seismic interpretations are difficult given the presence of volcanics in the basin, and basin fill may in fact be deeper.

This depth of fill is considered encouraging for hydrocarbon development given the high heat flows in the basin and, like at the Kito Prospect, seismic work has identified rollover structures at the end of several dip lines.

Moshi Basin leads



Source: Swala Energy

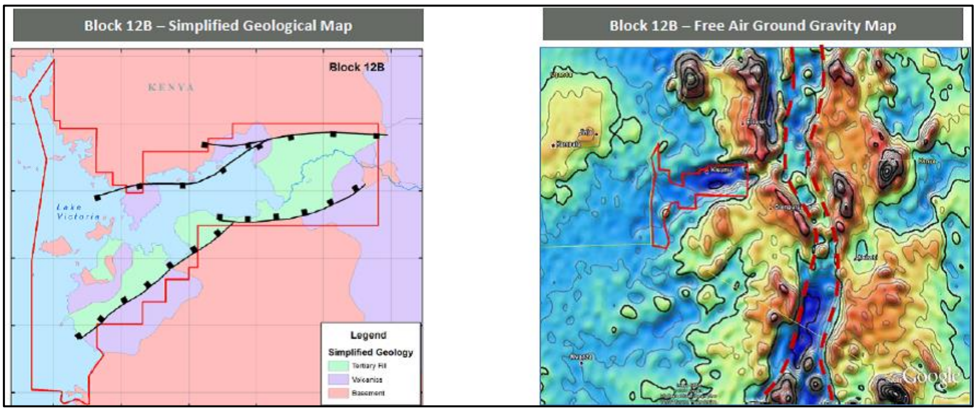
Kenya – Block 12B

Block 12B in Kenya is operated by Tullow and under-explored

Introduction and Tenure.

Block 12B, of 8,000km^2 gross, is held 50% by Swala (Kenya) and 50% by Tullow, which is the operator. This is located over the Nyanza Rift, an offshoot of the main EARS on the eastern side of Lake Victoria.

Block 12B location and gravity



Source: Swala Energy

Block 12B work commitments

Exploration Period	Contract Year	Work Commitments	Minimum expenditure commitment (US$)
Initial Exploration Period	Year 1	Reprocess all existing seismic, gravity and magnetic data; acquire block-wide high-resolution airborne gravity and/or magnetic data; conduct ASTER satellite and photogeology work; undertake surface geochemical sampling; and carry out field investigations.	350,000*
	Year 2	Acquire 700 km of 2D seismic either in the transition zone or on land and conduct additional geochemical sampling of minimum 1000 samples.	4,250,000
First Additional Exploration Period	Years 3 to 4	Either drill one exploratory well to a minimum depth of 2,000m or acquire 300km^2 of 3D seismic.	6,000,000
Second Additional Exploration Period	Years 5 to 6	Either drill one exploratory well to a minimum depth of 2,000m or acquire 300km^2 of 3D seismic.	6,000,000

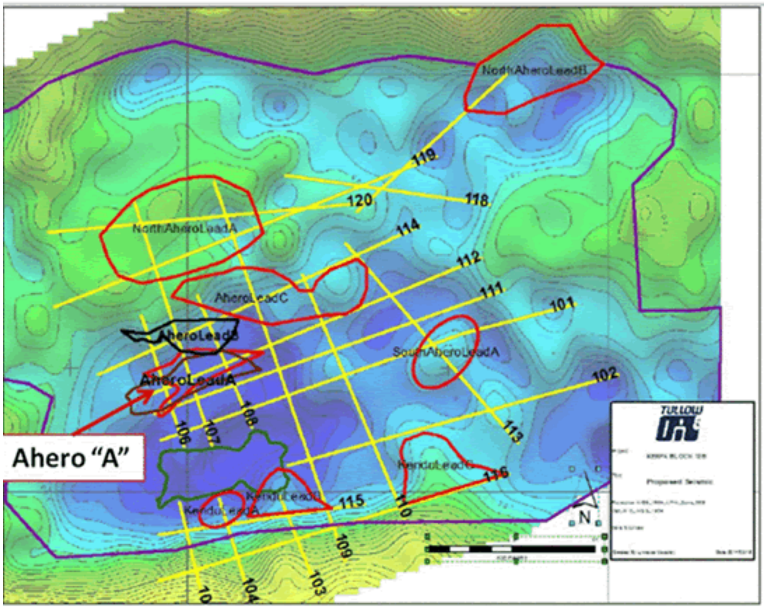
Source: Swala Energy

Work to date has included a re-appraisal of historic gravity and magnetics surveys and 350k of 2D seismic surveying

Work to date has included 350km of 2D seismic surveying over the eastern end of the survey area, which, from an appraisal of the historic gravity work, is interpreted as the basin depo-centre. This work has defined 10 leads, which include the Ahero-A and Ahero-A deep prospects, and containing net 2C prospective resources of 73.2MMboe as published by Tullow. The combined Ahero A leads are considered potential drill candidates for 2016.

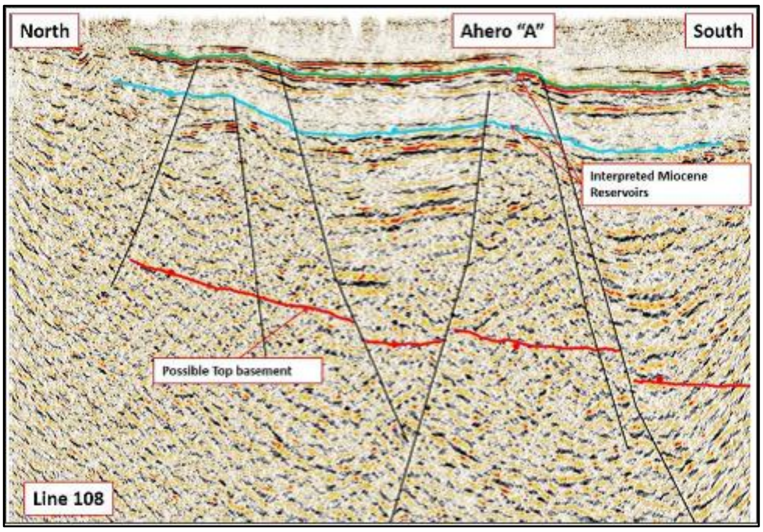
The seismic work has defined an east-west trending full graben, with the north and south normal boundary faults dipping towards the centre of the basin. The depth of the basin fill is as yet undetermined.

Block 12b seismic lines and leads



Source: Swala Energy

Block 12B seismic line 108



Source: Swala Energy

This work has identified 10 leads and prospects

Un-risked best estimate prospective resources of 73.2MMbb (net to Swala) have been ascertained

Block 12B un-risked net leads and prospective resources

	Leads and Prospects STOIIP (mmboe)				Prospective Resources (mmboe)			
Leads/ Prospect	**P90**	**P50**	**P10**	**Mean**	**P90**	**P50**	**P10**	**Mean**
Kendu A	2.5	13.6	64.6	24.8	0.4	2.1	10.7	4
Kendu B	5.2	26.9	125.7	48.5	0.7	4.2	20.7	7.9
Kendu C	7.1	34.1	153.9	60.2	0.9	5.2	25.4	9.8
Ahero A	7.1	39	195.9	76	0.9	5.4	31.7	11.8
Ahero A Deep	11.6	54.9	256.5	101.3	1.5	7.9	41.4	15.7
Ahero B	10.4	46.1	191.9	77	1.4	6.5	30.9	11.9
Ahero C	7.3	61.2	466.4	165.2	1	9.4	75.2	26.7
North Ahero A	21.5	117.9	584	223.4	3	18.1	96.5	36.2
North Ahero B	15.5	78.5	363.6	141.4	2.2	12	60.3	22.9
South Ahero A	3.6	15.8	66.9	26.7	0.5	2.45	11.1	4.4
Total	**91.9**	**488.2**	**2,469**	**944.5**	**12.5**	**73.2**	**403.8**	**151.3**

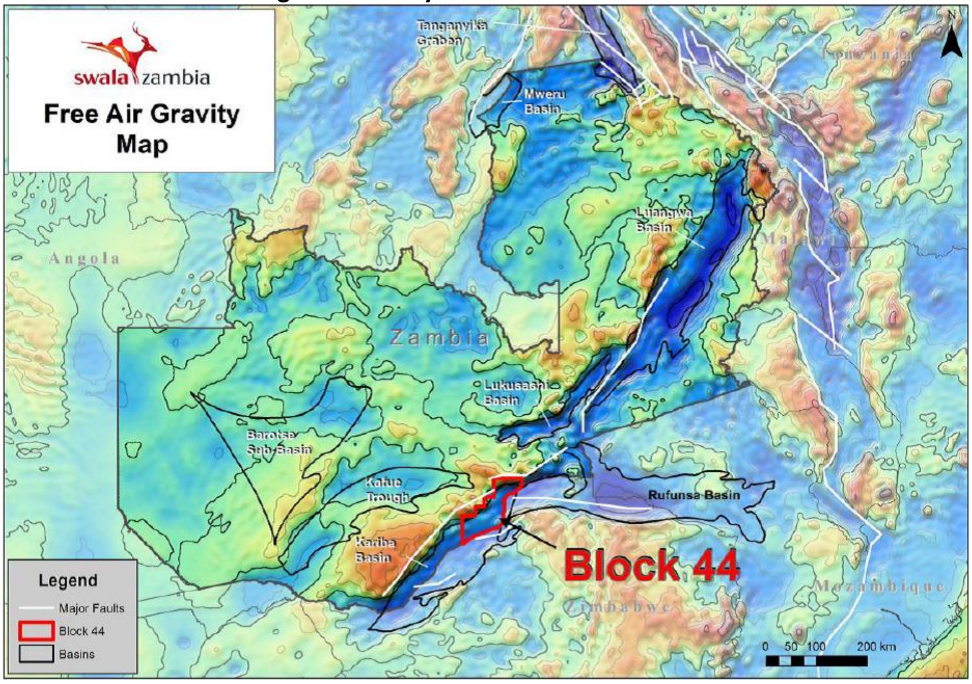
Source: Swala Energy

Zambia Block 44

The Company has accepted the offer of Block 44 in Zambia, located over units of the Karoo System

Block 44, of 6,000km^2 gross, was offered to Swala in May 2014, and accepted in September for an initial two year period. The block, as shown in the figure below, is located over what is interpreted as a thick sequence of Karoo system sediments in the margins of the Kariba Basin.

Block 44 location showing sedimentary basins



Source: Swala Energy

The basin is undrilled; however Mobil undertook exploration in the 1980's. Swala is currently evaluating the historic data, including the entire legacy seismic data set over Block 44.

Breakaway's View

With its extensive acreage and forthcoming drill programs in the highly prospective and underexplored EARS, Swala offers investors a highly leveraged entry into an exciting region, which is shaping up as a prospective major oil producer.

The recent exploration successes (and rapid progression to appraisal and declared commerciality) in other areas of the EARS that exhibit interpreted similarities to Swala's acreage, gives us confidence in the chances of success of the upcoming drilling, with three wells due to be spudded in early 2016.

Commercially, Swala has acted prudently to the recent falls in oil prices and tight capital markets for exploration, and as such, dependent upon the successful completion of the farm-out of the Tanzanian interests, will be fully funded with respect to the upcoming Tanzanian drilling. However, Swala will need to look at options for funding their 50% interest of Block 12B.

We rate Swala as a SPECULATIVE BUY

Given the above, and the extensive experience of the Board and Management, we rate Swala as a SPECULATIVE BUY. Price movers will be positive results from the upcoming drilling, however completion of the TPL farm-out and an agreement on Block 12B in Kenya are also potential price movers.

Background - The East African Rift System

Geological History and Stratigraphy

The EARS, a 3,500km long classic continental rift system, includes two key subdivisions – the Eastern and Western Branches

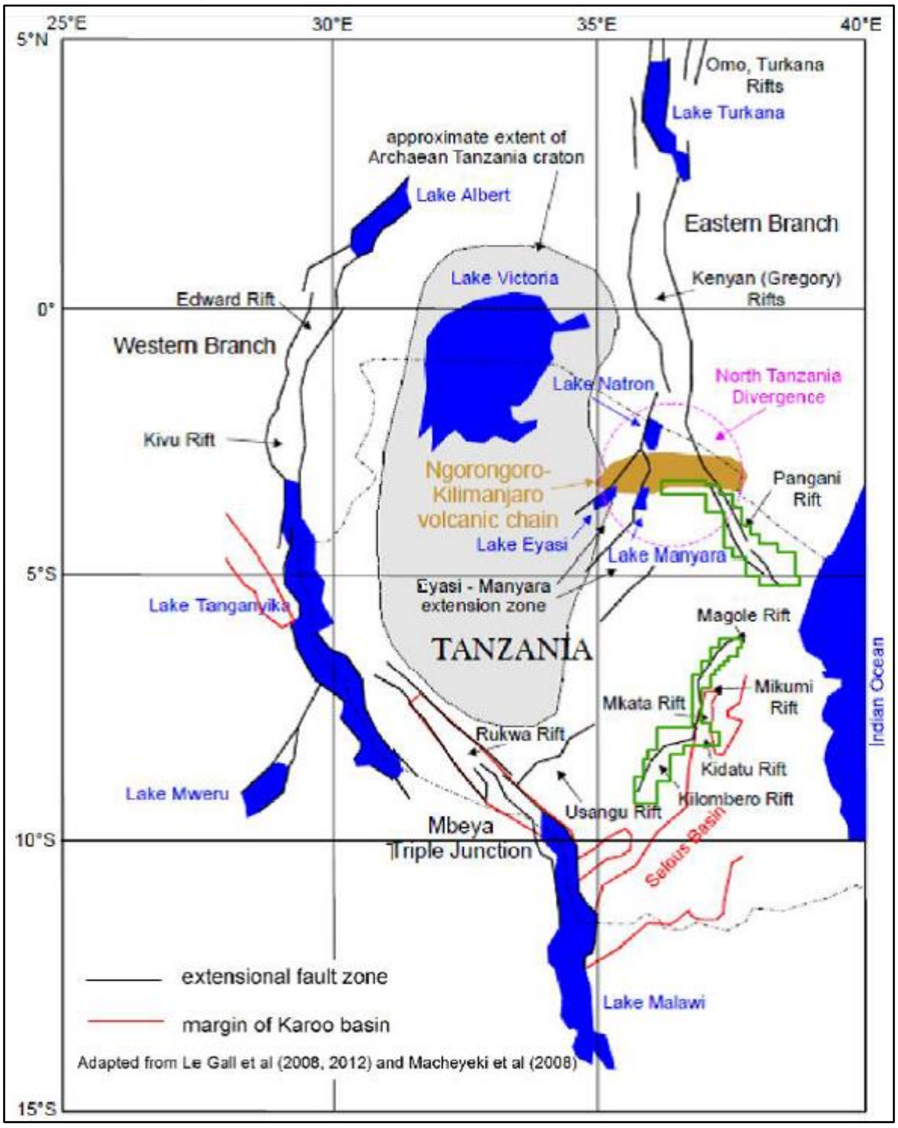
The EARS, a classical example of a continental rift, comprises a number of narrow (50-150km wide) elongate grabens and half-grabens, with a total length of some 3,500km in East Africa. The EARS comprises two main branches; the Eastern Branch and Western Branch that pass either side of the Archean Tanzanian Craton.

The Eastern Branch is the older of the two, with initiation of rifting during the mid-Oligocene at around 30Ma in the South Lokichar Basin, with the Western Branch initiation during the mid to late Miocene, at around 10Ma, however these ages are generally poorly defined. Both systems are seismically active, with more volcanism in the Eastern Branch.

Rift geometry is interpreted as being largely controlled by trends within the Neoproterozoic mobile belts and the Carboniferous to Triassic Karoo System geometry.

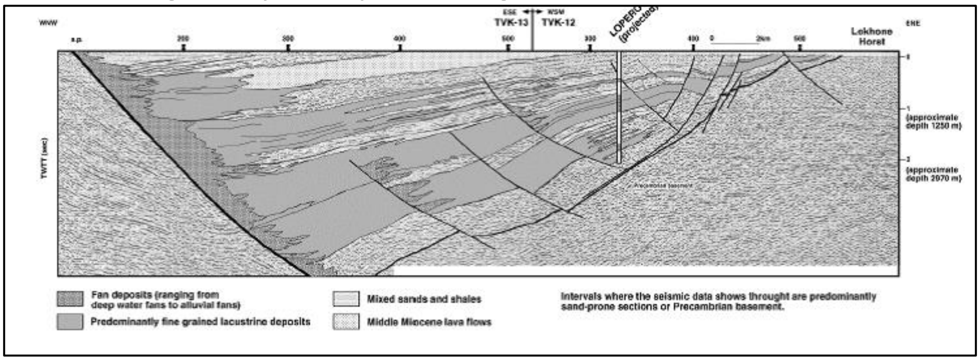
Rift boundaries are marked wither by single normal faults (half-grabens), else a symmetrical pair linking at depth to a low angle detachment fault (grabens). Internal normal faulting has led to the development of rotated blocks within the rift.

East African Rift System



Source: RISC Independent Expert's Report on the Kito Prospect

Lokichar Basin geometry – example of a half-graben



Source: RISC Independent Expert's Report on the Kito Prospect

Rift fill is dominated by fluvio-lacustrine sediments, with some volcanics also present. The lacustrine sediments appear to form the best source rocks, and areas of these units (e.g. in the Lake Albert Rift) are often associated with oil seeps. In the Lokichar Basin the Lokone Shales form good source rocks. However there can be fairly rapid facies changes and variability along strike, particularly where the sediments have been replaced by volcanics.

Exploration History and Discoveries

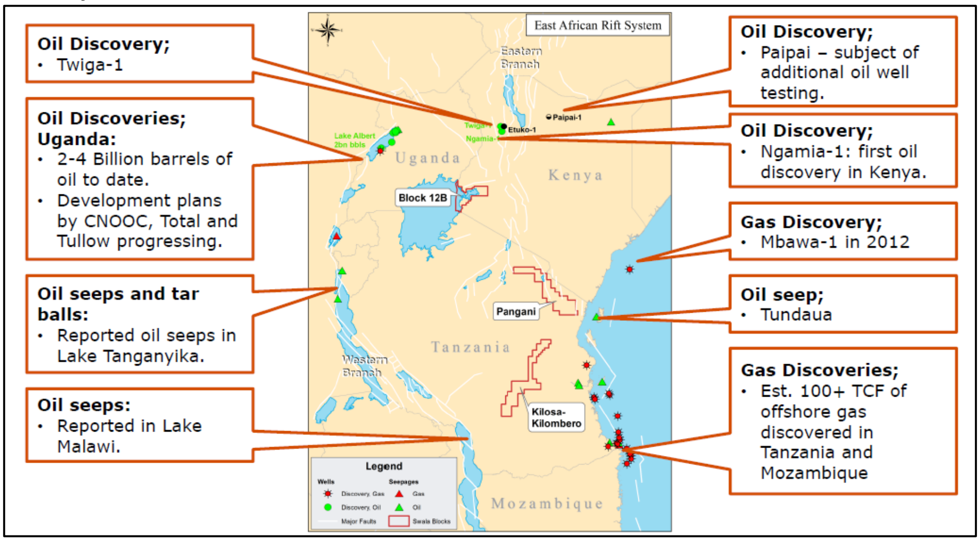
Exploration has been concentrated on two main areas – the Albertine Graben in Uganda and the South Lokichar Basin in Kenya

Introduction

Exploration has been concentrated on two main areas, the Albertine Graben in Uganda and the South Lokichar Basin in Kenya. These are both the sites of discoveries, with, as mentioned previously, around 2.3 billion barrels of 2C resources being reported, and with more than 20 fields being discovered. Only limited work has been carried out over the other rifts in the EARS, with these including areas held by Swala.

A snapshot of occurrences and discoveries is shown below.

EARS hydrocarbon occurrences and discoveries



Source: Swala Energy

The hydrocarbon potential of the Albertine Graben was first recognised in the 1920's, with serious exploration commencing in 1997

Albertine Graben - Uganda

Oil seeps have been recognised within the Albertine Graben for a number of years, with hydrocarbon potential first recognised during the 1920's. Serious exploration started in 1997, with Tullow being the key operator over the last nine years, holding acreage over the prime areas of the rift.

The first hydrocarbon discovery was made by Heritage Oil in 2003, with deep gas intersected at Turaco to the SW of Lake Albert. Oil first flowed in 2006 in

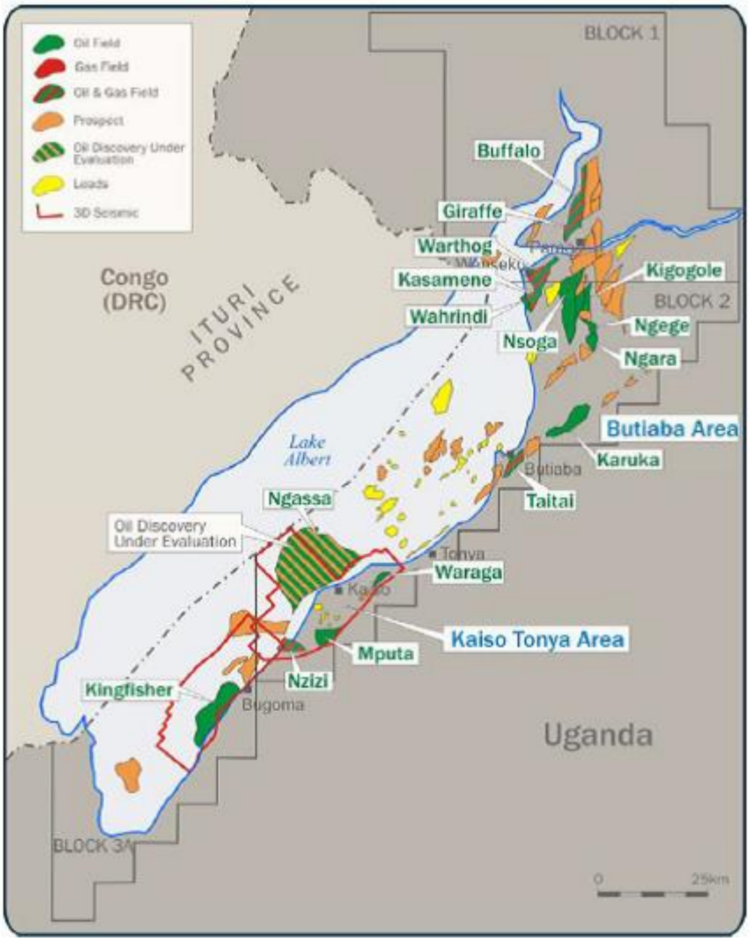
First gas was discovered in 2003, with oil being discovered in 2006

Tullow/Hardman Resources' Mputa-1 well, closely followed by Waraga-1. These were then followed by Kingfisher field well KF-1, with all wells generating significant flows on test. Subsequent work has seen a number of additional discoveries along the graben.

Oil occurs in a number of separate basins along the rift, with up to 1.7 billion barrels of 2C resources being delineated

The geology comprises a number of separate basins along the rift, with individual pools hosting between ~10 and 300 million barrels of 2C resources. Sediment depths are up to ~5km. Tullow has reported commercialised resources for Uganda of 604MMboe, with total 2C resources in the graben now reported as being around 1.7 billion barrels.

Lake Albert hydrocarbon discoveries



Source: RISC Independent Expert's Report on the Kito Prospect

Lokichar Basin

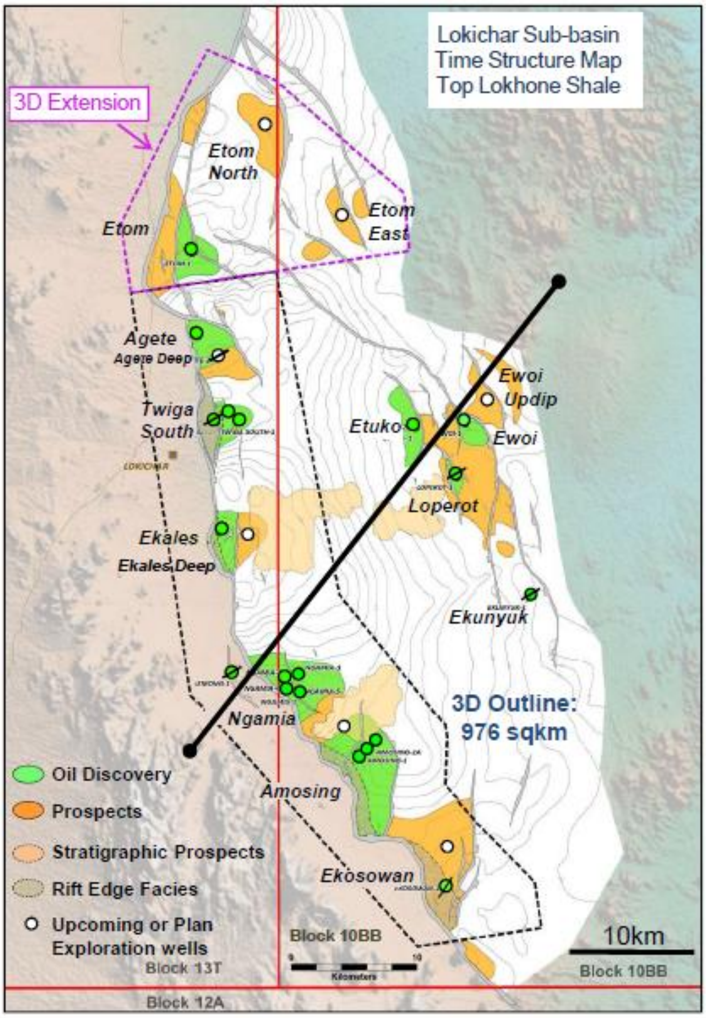
Lokichar is located in Kenya in the Eastern Branch of the EARS.

The first discovery was made in 1992, with Shell's Loperot-1 well intersecting oil in Block 10B. In 2013 the acreage was held by a Tullow/Africa Oil JV. In January 2012 well Ngamia-1 intersected over 100m of net oil pay, in an overall 650m interval of the Upper Lokhone Sandstone.

The first Lokichar discovery was in 1992, with over 600 million barrels of 2C resources being reported in eight discoveries to date by Africa Oil

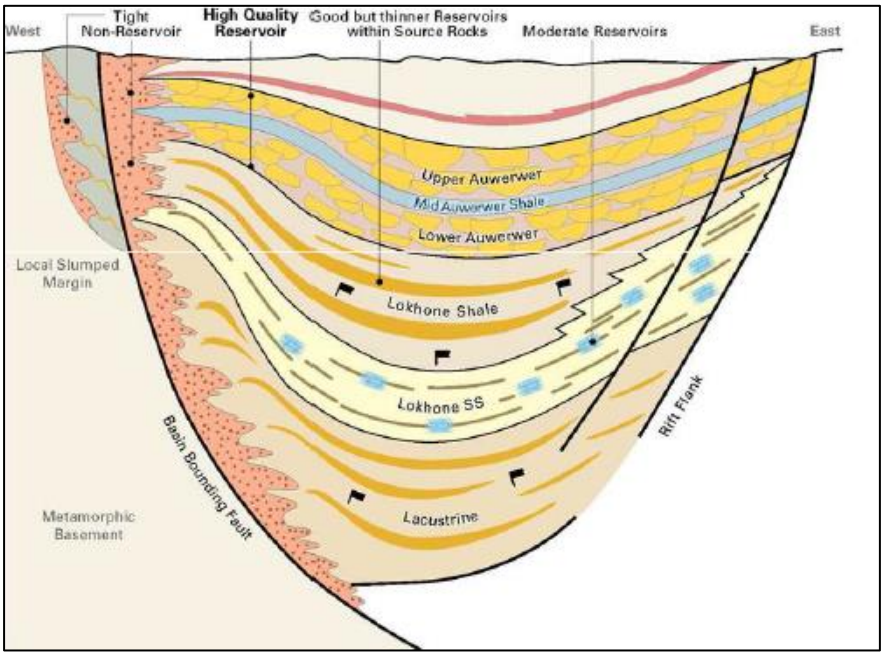
Subsequent exploration has led to a number of other discoveries, with Africa Oil reporting over 600 million barrels of 2C gross resources in eight discoveries, which have been described as a "string of pearls" largely along the western margin of the basin. According to Africa Oil the well success rate has been 72%, with significant upside remaining in the basin.

Lokichar Basin hydrocarbon discoveries



Source: Africa Oil November 2014 presentation

Lokichar Basin cross section



Source: Africa Oil November 2014 presentation

Africa Oil is now drilling additional basins and rifts along its extensive acreage over the Eastern Branch of the EARS.

Summary – Production Sharing Contracts

Swala's acreage is held under production sharing contracts ("PSC") with the respective governments. Key terms of the Tanzanian and Kenyan PSC's are given below.

Tanzanian PSC summary

	Kilosa Kilombera	Pangani
Date	February 20, 2015	February 20, 2015
Area	17,675km^2	17,156km^2
Interests (subject to approval of farm-out	SOGTP – 25% - operator TPL – 25% Otto – 50%	SOGTP – 25% - operator TPL – 25% Otto – 50%
Government back-in right	20% (carried during exploration)	20% (carried during exploration)
Term	4+4+3 (with opt out right after years 1 and 2)	4+4+3 (with opt out right after years 1 and 2)
Work programmes and commitments	Refer to tables in relevent sections of project descriptions	
Licence rental fees	2012-2015: US$70,700pa	2012-2015: US$78,600pa
Training fee	US$200,000pa	US$200,000pa
Relinquishments	25% at end of year 4 25% at end of year 8	25% at end of year 4 25% at end of year 8

Source: Swala Energy

Kenyan PSC summary

	Block 12B
Date	February 16, 2015
Area	8,000km^2
Interests	SEKL – 50% Tullow – 50% - Operator
Government back-in right	10% (carried during exploration)
Term	2+2+2
Work programmes and commitments	Refer to tables in Block 12B project description
Signature Bonus	US$300,000
Licence rental fees	2012-2013: US$40,000pa 2014-2015: US$80,000pa
Training fee	US$100,000pa
Relinquishments	Usually 25% at end of year 2, 25% at end of year 3 Full acreage has actually been retained

Source: Swala Energy

The governments of both countries have the right, should the licences proceed to development (following the exploration and appraisal stages), to take an equity stake in the development; 10% in the case of Kenya and 20% in the case of Tanzania. They will then contribute pro-rata to the costs of development.

Should the fields end up producing, the relevent Government will then take a share of production. The production sharing allows for a quantity of production to be reserved for cost recovery by the contractors, with production above this being shared according to a sliding scale based on daily flow rates.

Directors and Management

Non-Executive Chairman
Mr. Ken Russell

Mr. Russell has over 35 years of oil and gas industry experience and he has held a number of managerial roles and directorships in the oil and gas industry. These range from positions of Base Manager through to Managing Director and CEO of listed entities. Mr. Russell was also a founding director of ASX listed companies, Bounty Oil and Gas NL and Key Petroleum Ltd. In parallel with his involvement in the oil and gas industry he has considerable experience, developed over the last 25 + years, in international business having owned and operated a number of privately held companies.

CEO and Managing Director
Dr. David Mestres Ridge

Dr. Mestres Ridge worked first for Total Oil Marine (1998-2000) and then as an independent M&A and business development advisor to oil companies active in the North Sea and North Africa (2000-2006). From 2006-2008 he was a Vice-President at the Royal Bank of Canada, first in the Global Investment Banking Oil and Gas team and then in the Equity Research team. In 2008-2009 Dr. Mestres Ridge briefly managed Petrodel Resources, a company active in Tanzania. In 2009-2010 he worked with Black Marlin Energy during its IPO on the Toronto Stock Exchange. Dr. Mestres Ridge has a BSc in Applied Geology, an MSc in Mining Geology, a PhD in Chemical Engineering and an LLM in Law.

Non-Executive Director
Mr. Peter D. Grant

Peter holds a B.Sc. (Hons.) in Geology from Nottingham University. Mr. Grant has over 35 years' experience in exploration, first gained as a Geophysicist/Party Chief with Seismograph Services Limited (1974-1979). He was then Senior Geophysicist for British Gas (1979-1982) before joining BHP Petroleum where, from 1982-1995, he was Exploration Manager in Africa and the Middle East; Project Manager in Myanmar; and General Manager in Yemen. In 1995 Mr. Grant joined Woodside Energy Limited, where he was Exploration Manager N. Australia (1995-1997); International Exploration Manager (1998-2003); General Manager UK (2000-2006); and General Manager International Exploration (2006-2013).

In his latest role as Woodside's first International Exploration Manager he was asked to establish a high quality team capable of generating a successful strategy and portfolio that would meet with Woodside's growth aspirations. Woodside's international portfolio now spans the Gulf of Mexico, Brazil, Peru, Korea, Algeria and the Canaries. Mr. Grant was a director of Woodside Energy UK, Woodside Energy West Africa, Woodside Energy North Africa, Woodside Energy Sierra Leone, Woodside Energy Mauritania BV and President of Woodside Energy Iberia. He is also Deputy Chairman for the Arab Australian Chamber of Commerce and Industry and a Board member of the Australia Korea Business Council of Western Australia.

Non-Executive Director
Mr. Ernest Massawe

Mr. Massawe is a Certified Accountant (ACCA, UK) and holds a Bachelors of Commerce from the then University of East Africa – Nairobi. He is the founder as well as the former Chairman and Managing Partner of what is now the Ernst and Young Tanzania practice after having led the firm for the past 30 years until his retirement on 31st December 2010. Mr. Massawe is widely respected within the professional and business community in Tanzania, evidenced by his many high profile appointments in the Accountancy profession, Financial services, Mining and Capital Markets sectors.

Mr. Massawe was the founder and chairman of the Tanzania Association of Accountants/Board Member of the National Board of Accountants and Auditors and the first chairman of the Dar es Salaam Stock Exchange and the Tanzania Chamber of Mines. He has also served on the Banking and Financial Sector Reform Committee, The Value Added Consultative Board, the USAID sponsored Tanzania Business Centre Advisory Board and the Ministry of Finance's Think Tank on Tax Reform and Fiscal Policy. As an entrepreneur, Mr. Massawe has interests in micro-finance, banking, insurance brokerage, real estate development, medium scale gemstone mining and stock brokerage. He is also a director in a number of leading companies in Tanzania.

Non-Executive Director
Mr. Mohammed Ishtiaq

Mohammed Ishtiaq is a Director of the Hayaat Group, a private investment company headquartered in Abu Dhabi that holds a substantial shareholding in Swala Energy Limited. Mr Mohammed Ishtiaq worked for British Aerospace in the defence industry for 6 years following graduation from Leeds Metropolitan University. He then moved to the Fast Moving Consumer Goods ("FMCG") sector building a career over 25 years and where at a senior level specialising in retail and wholesale development concepts he conducted extensive evaluation of markets in the Middle East. Throughout the last 15 years Mohammed Ishtiaq has been involved with very successful large commercial and development projects in the property sector, something that he was able to achieve through an ability to build strong relationships with stakeholders and joint venture partners.

Non-Executive Director
Mr. Frank Moxon

Mr Moxon is the Managing Director of Hoyt Moxon Ltd, a corporate finance consultancy. He is also Chairman of Imperial Minerals Plc and a director of the Chartered Institute for Securities & Investment ("CISI"). He has over 25 years' experience as a corporate financier to developing and growth companies in a wide range of industrial sectors, but has specialised for some 17 years in natural resources. He is or has been a director of a number of companies quoted on the stock exchanges of London, Australia and Canada.

Mr Moxon is a former head of corporate finance at Williams de Broë Plc., a large and well respected Broker in London and was senior independent non-executive director at Cove Energy Plc until its August 2012 sale to PTTEP for £1.2 billion. He has a BSc in Economics and is a Chartered Fellow of the CISI and a Fellow of the Energy Institute and of the Institute of Materials, Minerals & Mining.

New Ventures Manager
Mr. Neil C. Taylor

Mr. Taylor is the former Exploration Manager of East African Exploration Limited ("EAX"), Black Marlin Energy's E&P subsidiary. A geologist by background, Mr. Taylor has over 30 years of experience in the oil and gas business with internationally renowned E&P companies including British Petroleum (1981-1992) and Woodside Energy (1992-2007). Through his time with those companies Mr. Taylor has been involved with or led exploration and production activities world-wide, including significant work with the giant gas fields of the northwest shelf of Australia and exploration in Europe, North Sea, South East Asia, Australia and the Middle East. Mr. Taylor joined EAX in 2008 with the remit of growing the company's asset base, and added six new licences to EAX's portfolio during his tenure.

Biographies extracted from Company Website – June 18, 2015

Analyst Verification

We, Grant Craighead and Mark Gordon, as the Research Analysts, hereby certify that the views expressed in this research accurately reflect our personal views about the subject securities or issuers and no part of analyst compensation is directly or indirectly related to the inclusion of specific recommendations or views in this research.

Disclosure

Breakaway Investment Group (AFSL 290093) may receive corporate advisory fees, consultancy fees and commissions on sale and purchase of the shares of Swala Energy and may hold direct and indirect shares in the company. It has also received a commission on the preparation of this research note.

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